FOR ARGUMENT

Supreme Court, U. S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1977

No. 77-1645

TRANSAMERICA MORTGAGE ADVISORS, INC. (TAMA); KENT L. COLWELL; J. WENDELL COOMBS; JOHN R. JENSEN; RALPH D. WENGER; JOHN HAVENS; TRANSAMERICA CORPORATION; TRANSAMERICA LAND CAPITAL, INC.; AND MORTGAGE TRUST OF AMERICA,

Petitioners,

—v.—

HARRY LEWIS,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

REPLY BRIEF FOR PETITIONERS

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REPLY BRIEF FOR PETITIONERS

INTRODUCTION

This brief for petitioners is in reply to various arguments made by respondent, and includes comment on certain points in the *amicus* briefs filed by the Securities and Exchange Commission and by the plaintiffs in the *Sullivan* case.[1]

1. *Sullivan v. Chase Investment Services of Boston, Inc.*, U.S.D.C., N.D. Cal., No. C 76-1783 CBR.

ARGUMENT

There is no showing in any of the three briefs filed in support of respondent's position that "the creation by judicial interpretation of [an] implied cause of action is *necessary* to effectuate Congress' goals" in enacting the Advisers Act. *See, Piper v. Chris-Craft Industries, Inc.*, 430 U.S. 1, 26 (1977) (emphasis added).

The only departure from well-ploughed ground is respondent's repeated reference to the Securities Exchange Act of 1934 and Section 215(b) of the Advisers Act. Respondent's reliance on the 1934 Act and on Section 215(b) of the Advisers Act is not justified and should be rejected.

1. The History, Objectives, Application and Interpretation of the Advisers Act and of the 1934 Act Differ Significantly.

Section 215(b) of the Advisers Act provides in effect that contracts made or to be performed in violation of the Act "shall be void."[2] In reliance on the foregoing provision and on Section 29(b) of the 1934 Act,[3] respondent argues that the Advisers Act implies a private right of action for equitable relief and money damages. (*See*, Brief for Respondent ("Res. Brief") at 39-43.) Respondent's argument may be summarized as follows:

> —Section 215(b) of the Advisers Act is "utterly indistinguishable" from Section 29(b) of the Securities Exchange Act of 1934. (Res. Brief 40).
>
> —Section 29(b) of the 1934 Act has been interpreted as support for the implication of a private right of action under the 1934 Act. (Res. Brief 40-41).

2. 15 U.S.C. § 80b-15 (1971). The complete text of Section 215 of the Investment Advisers Act is set forth at page 3a of the *Addendum* to Brief for Respondent.

3. 15 U.S.C. § 78cc(b) (1971).

> —Therefore, Section 215(b) of the Advisers Act should be interpreted as support for a private right of action under the Advisers Act. (Res. Brief 40-41).

Respondent's argument does not bear the burden of analysis. It is based upon erroneous assumptions, the use of questionable authority, and disregard of the limitations on private actions recently recognized by this Court.

Those cases which rely upon Section 29(b) of the 1934 Act to imply a private right of action were interpreting the 1934 Act. This obvious fact has been overlooked by respondent in his effort to show that the "thrust" of Section 29(b) is the same as that of Section 215(b) of the Advisers Act. (Res. Brief 40). Respondent ignores the fact that the history, objectives, application and interpretation of the two acts differ significantly. Petitioners and respondent may dispute the intent and purpose of the Advisers Act.[4] But there can be no dispute that the intent and purpose of the Advisers Act is *not* the same as the intent and purpose of the 1934 Act. The Advisers Act was enacted to regulate and protect a small segment of the securities industry.[5] The 1934 Act was enacted to regulate the marketing of securities generally.[6] Using the 1934 Act to interpret the Advisers Act provokes more questions than answers.

4. *Compare* Brief for Petitioners at pages 7-28 *with* Brief for Respondent at pages 20-56.

5. *See*, H.R. Rep. 2639, 76th Cong., 3d Sess., 28 (1940). *See also*, Brief for Petitioners at pages 22-23.

6. The 1934 Act is aimed at "the full range of ingenious devices that might be used to manipulate securities prices." *Santa Fe Industries Inc. v. Green*, 430 U.S. 462, 477 (1977).

2. Since the Advisers Act and the 1934 Act Differ Significantly, Interpreting and Applying the Two Acts in the Same Manner Is Not Justified.

Relying on Section 29(b) of the 1934 Act, respondent proposes the wholesale adoption of 1934 Act principles in the interpretation and application of the Advisers Act. Respondent sidles past the well-recognized problems the federal courts would encounter in attempting to define a private right of action under the Advisers Act, including questions of standing, problems of causation and reliance, and questions of intent.[7]

The problem is illustrated in the brief filed by the Securities and Exchange Commission as *amicus curiae*. The SEC argues that Section 206 of the Advisers Act, which makes certain acts by advisers unlawful, "has its own limits on the scope of liability" and that the statute "effectively limits the number of potential plaintiffs and rules out unforeseen liabilities to the general public." *See*, Brief for the Securities and Exchange Commission as Amicus Curiae ("SEC Brief") at page 44. In fact, Section 206 of the Advisers Act makes unlawful certain acts by investment advisers against a client *"or prospective client."*[8] Section 206 does *not* presuppose "the existence of a relationship of financial trust or reliance . . ." (SEC Brief 44). Section 206 does *not* limit plaintiffs to a "determinable class." (SEC Brief 44). Contrary to respondent's assurances, Section 206 does *not* limit private actions to a "limited class of persons

7. *See*, Note, *Private Causes of Action Under Section 206 of the Investment Advisers Act*, 74 Mich. L. Rev. 308, 331-338 (1975); Note, *Securities Law—Investment Adviser Fraud—A Private Damages Remedy Is Implied Under Section 206 of the Investment Advisers Act of 1940*, 30 Vand. L. Rev. 905, 920 (1977). *See also, Abrahamson v. Fleschner*, 568 F.2d 862, 884-887 (2d Cir. 1977) (Gurfein, J., concurring and dissenting).

8. 15 U.S.C. § 80b-6 (1971) (emphasis added).

who can assert claims in connection with the making or performance of an advisory contract, or a course of conduct in an advisory relationship . . ." (Res. Brief 59).

Interpreting Section 206 of the Advisers Act to allow a private right of action would destroy the purchase-or-sale limitation on actions under Section 10(b) of the 1934 Act recently recognized by this Court. *See, Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 733, 749 (1975). By definition, a "prospective client" of an investment adviser has neither purchased nor sold securities on the advice of the adviser. Allowing a "prospective client" to maintain an action against a "prospective" investment adviser would raise the same "conjectural as well as subjective issues" Mr. Justice Powell noted in *Blue Chip Stamps, supra* at 758 n. 2 (Powell, J., concurring).

3. There Is an Important Distinction Between Section 215(b) of the Advisers Act and Section 29(b) of the 1934 Act.

There are *no* cases holding that Section 215(b) of the Advisers Act implies a private right of action. Respondents recognize this fact, but argue that Section 215(b) of the Advisers Act is "utterly indistinguishable" from Section 29(b) of the 1934 Act. Section 29(b) is sometimes cited as a basis for implying a private right of action under Section 10(b) of the 1934 Act.[9] In fact, there is an important distinction between Section 215(b) of the Advisers Act and Section 29(b) of the 1934 Act. Section 29(b) was amended in 1938 to add a statute of limitations for certain violations

9. *See, Fischman v. Raytheon Mfg. Co.*, 188 F.2d 783, 787 n.4 (2d Cir. 1951); *Kardon v. National Gypsum Co.*, 49 F.Supp. 512, 514 (E.D. Pa. 1946).

of the 1934 Act.[10] Section 215(b) of the Advisers Act contains no such provision.

The distinction is significant.

The existence of a statute of limitations in Section 29(b) of the Securities Exchange Act is the *very reason* various courts have interpreted Section 29(b) as affording a private right of action. *See, Fischman v. Raytheon Mfg. Co.*, 188 F.2d 783, 787 n. 4 (2d Cir. 1951); *Kardon v. National Gypsum Co.*, 69 F.Supp. 512, 514 (E.D. Pa. 1946). As explained in *Kardon,* the statute of limitations amendment to Section 29(b) "clearly contemplates that Congress meant the original statute to be interpreted as providing for civil suits under it." *Kardon v. National Gypsum Co., supra* at 514.[11]

The addition of a statute of limitations to Section 29(b) of the 1934 Act has been interpreted as support for a private right of action. *Fischman v. Raytheon Mfg. Co., supra* at 787 n. 4; *Kardon v. National Gypsum Co., supra* at 514. But unlike Section 29(b), Section 215(b) of the Advisers Act has *not* been amended and does *not* contain a statute of limitations. By analogous reasoning, one would conclude that Congress did not regard Section 215(b) of the Advisers Act as the basis for private action.[12]

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10. *See,* Act of June 25, 1938, c. 677, § 3, 52 Stat. 1076 (*amending* 15 U.S.C. § 78cc (1971)).

11. *See also, Geismar v. Bond & Goodwin, Inc.*, 40 F.Supp. 876, 878 (S.D.N.Y. 1941).

12. Reliance on Section 215(b) of the Advisers Act as the basis for implying a private remedy has been called "inconclusive" and "is arguably offset by indications in the Act's legislative history of congressional reluctance to 'over-regulate' the advisory industry, which suggest a desire to minimize the potential liability of advisers." Note, *Private Causes of Action Under Section 206 of the Investment Advisers Act,* 74 Mich. L. Rev. 308, 319-320 (1975) (footnote omitted).

4. Various Considerations Belie Respondent's Argument That Section 215(b) of the Advisers Act Implies a Private Right of Action.

The following considerations are pertinent in evaluating respondent's argument that Section 215(b) of the Advisers Act implies a private right of action:

(1) There is nothing in the legislative history of Section 215(b) of the Advisers Act to support the conclusion that it creates a private right of action—legal or equitable.[13] Respondent offers no citations to the contrary.

(2) Professor Loss notes that Section 29(b) of the 1934 Act implies a private remedy "only when plaintiff and defendant are in privity of contract, or perhaps when the plaintiff can work out a third-party beneficiary relationship." 3 Loss, Securities Regulation 1759 (2d ed. 1961). The Advisers Act does not require privity of contract or a third-party beneficiary relationship. As noted above, Section 206 makes unlawful certain acts by an investment adviser against a client or "prospective client." A "prospective client" by definition is *not* in privity of contract with the adviser, nor is he a third-party beneficiary of the adviser's services.

(3) The inclusion of "prospective client" in the coverage of Section 206 of the Advisers Act was almost certainly intended to give the Securities and Exchange Commission wide latitude in the use of the Act's enforcement powers. The inclusion of "prospective client" in the coverage of Section 206 complements Section 209,

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13. *See,* Brief for Respondent at page 30, where respondent acknowledges that there is no evidence Congress ever expressly considered the problem of private actions when it enacted the Advisers Act. *See also,* Brief for Petitioners at pages 7-25.

which empowers the Commission to seek an injunction against persons "about to engage in" or "aiding, abetting, counseling, commanding, inducing, or procuring" a violation of the Act. *See,* 15 U.S.C. § 80b-9 (1971). The inclusion of "prospective client" in Section 206 is consistent with enforcement of the Advisers Act by the Commission—and wholly inconsistent with the limitations on private securities law actions recently recognized by this Court. A class of "prospective client" plaintiffs has no practical limits.

(4) Rather than creating a private implied right to *affirmative* action, Section 215(b) may be read as establishing a *defense* to an action based on an investment adviser contract. This interpretation is suggested by the fact that Section 215(b) of the Advisers Act was apparently based on state blue sky laws,[14] which in turn are based on the familiar common law principle that illegal or unlawful contracts will not be enforced.[15]

(5) Implying a private right of action for rescission, as respondent requests, would open the door to the award of money damages.

Respondent appears to recognize that it would be difficult for this Court to imply a private right of action for money damages under the Advisers Act (*See,* Res. Brief 39-43). To salvage his money damage claims, respondent argues

14. *See,* 3 Loss, Securities Regulation 1758-1759 (2d ed. 1961), where Professor Loss states that Section 215(b) of the Advisers Act and similar provisions in the other federal securities laws "have ample precedent in the blue sky laws."

15. *See,* 17 C.J.S. Contracts, § 272, 1188-1197 (1963); 14 Cal. Jur.3d, Contracts § 140, 368-370 (1974); *Lee On v. Long,* 37 Cal.2d 499, 502-503, 234 P.2d 9 (1951); *Franklin v. Nat C. Goldstone Agency,* 33 Cal.2d 628, 632, 204 P.2d 37 (1949).

that as part of his rescission action, the District Court should be empowered to "dispose of all claims, even if the only remedy found proper is an award of damages on the legal claims." (Res. Brief 41). Respondent's proposal would undermine existing distinctions between claims for equitable relief and actions for money damages, and is another reason why Section 215(b) should not be interpreted as creating a private cause of action—legal or equitable.

5. Congress Is in the Best Position to Create and Limit a Private Right of Action Under the Advisers Act.

Respondents would have the federal courts interpret and limit the private right of action proposed under the Advisers Act. Interpreting statutes may well be a "quintessential business of the federal courts". (Res. Brief 57). But we think it evident that creating and limiting private remedies under the federal securities laws is a task best left to Congress.

In 1970 Congress amended both the Investment Company Act and the Advisers Act.[16] Congress added an express private right of action to the Investment Company Act, but added *no* such right to the Advisers Act.

The amendments to the Investment Company Act were carefully drawn and cover virtually all of the questions that would otherwise be left open to litigation. Among other provisions, the amendments to the Investment Company Act creating an express right of action (1) impose a carefully-defined fiduciary duty on certain investment advisers; (2) specify and limit the persons or entities who may be defendants; (3) specify and limit the persons or entities who may bring the action; (4) allocate the burden of proof

16. Public Law No. 91-547, 84 Stat. 1413 (1970).

and establish evidentiary standards; and (5) limit the nature and extent of the damages which may be recovered. *See,* 15 U.S.C. § 80a-35 (1971).

No such rights and limitations have ever been a part of the Advisers Act.

Congress has shown it will create private rights of action as necessary. When it creates a private right of action, Congress has devoted careful attention to the issues that would otherwise plague the federal courts if the right arose from judicial implication. Congress has created express private rights of action as necessary. Congress is in the best position to define and limit the remedies it creates. *Accord, Abrahamson v. Fleschner,* 568 F.2d 862, 883-884 (2d Cir. 1977) (Gurfein, J., concurring and dissenting).

6. The Investment Advisers Act Does Not Apply to Petitioners.

Finally, we respectfully direct attention to a procedural aspect of this case which has been the subject of argument to this Court by the plaintiffs in the *Sullivan* case as *amici curiae.*[17]

When petitioners asked the District Court to dismiss this case, they argued (1) that neither the Investment Company Act nor the Investment Advisers Act applies to petitioners; (2) that petitioners Transamerica Mortgage Advisors, Inc. (TAMA), and Transamerica Corporation

17. *See,* Motion for Leave to File Brief Amicus Curiae and Brief Amicus Curiae in Support of Respondent, dated January 31, 1979, submitted by the plaintiffs in *Sullivan v. Chase Investment Services of Boston, Inc.,* U.S.D.C., N.D. Cal., No. C 76-1783 CBR. The *Sullivan* case is reported at *Sullivan v. Chase Investment Services of Boston, Inc.,* 434 F.Supp. 171 (N.D. Cal. 1977) (implying a private right of action under the Investment Advisers Act); and at *Sullivan v. Chase Investment Services of Boston, Inc.,* 79 F.R.D. 246 (N.D. Cal. 1978) (certifying a class action).

are exempt from registration in any event; (3) that respondent did not excuse his failure to make demand on the trustees of Mortgage Trust of America; and (4) that the Advisers Act does not afford a private right of action.[18]

The District Court remarked that all of petitioners' arguments had "substantial merit," but found it unnecessary to rule on all of the arguments since the Advisers Act does not afford a private right of action.[19]

On appeal, petitioners again urged consideration of the arguments that the Advisers Act does not apply to the petitioners, and that the respondent had not excused his failure to make demand on the trustees of Mortgage Trust of America. (A. 30). The Court of Appeals declined to consider those arguments, and said that since the District Court "did not adjudicate those issues . . . we decline to now do so." (A. 30) (citations omitted).[20]

18. Petitioners explained to the District Court (R. 246-253) and to the Court of Appeal (A. 30) that Mortgage Trust of America is a mortgage lender, and that since mortgages are not "securities" within the meaning of the federal securities laws, neither the Investment Company Act nor the Advisers Act applies. *See, United Housing Foundation v. Forman,* 421 U.S. 837 (1975).

19. "I think there is substantial merit to a number of various other contentions that the [petitioners] have made here but I find it unnecessary to reach any of those if I can't get over the initial jurisdictional requisite. So my present view is that the Investment Advisers Act simply does not provide [respondent] a private cause of action. There is no Federal jurisdiction and that this complaint should be and must be dismissed." (Reporter's Transcript 10, included as Volume III of the record transmitted to this Court by the Court of Appeals on January 10, 1979.)

20. In support of their request that the Court of Appeals rule on the alternate arguments presented to the District Court, petitioners cited various authorities, including *Helvering v. Gowran,* 302 U.S. 238 (1937), where Mr. Justice Brandeis commented that in the review of judicial proceedings "the rule is settled that, if the decision below is correct, it must be affirmed, although the lower court relied upon a wrong ground or gave a wrong reason." *Id.* at 245.

In an *amicus* brief filed in support of the respondent, the plaintiffs in *Sullivan v. Chase Investment Services of Boston, Inc.*, U.S.D.C., N.D. Cal., No. C 76-1783 CBR, state that this case "*does not* present the type of fraudulent conduct which the Investment Advisers Act was expressly established to prevent . . ." (Sullivan Brief 7) (emphasis in original). The plaintiffs in *Sullivan* further state that it is "questionable" whether TAMA "is in fact an investment adviser at all within the meaning of the Advisers Act . . ." or whether TAMA "rendered advice with respect to a 'security' as that term is defined by the Advisers Act . . ." (Sullivan Brief 8).

We agree. But since the courts below declined to consider petitioners' other arguments, we are before this Court on the only decided issue, namely, whether the Advisers Act affords a private right of action.

We are mindful of this Court's reluctance to decide issues that have been passed over by the lower courts. *See, United States v. United Continental Tuna Corp.*, 425 U.S. 164, 181-182 (1976); *Wood v. Strickland*, 420 U.S. 308, 326-327 (1975); *and see*, 17 Wright, Miller & Cooper, Federal Practice and Procedure § 4036, 28 (1978). As Mr. Justice Harlan once explained, where issues have not been considered by the Court of Appeals, "this Court will not ordinarily consider them." *Adickes v. S.H. Kress & Co.*, 398 U.S. 144, 147 n. 2 (1970) (citations omitted).

At the same time, we are aware of circumstances where this Court has decided issues that were not decided below. Reasons given include the desire to terminate lengthy proceedings,[21] the findings of a preferred ground for disposition,[22] or the presence of a clear issue.[23] In *Fry v. United States*, 421 U.S. 542 (1975), for example, this Court dealt with a statutory issue first raised in *amicus* briefs "rather than decide a constitutional question when there may be doubt whether there is any statutory basis for it, . . ." *Id.* at 545 n. 5.

We continue to believe that neither the Investment Company Act nor the Advisers Act applies to the petitioners here. The mortgage loans involved in this case are not "securities" within the meaning of the federal securities laws, and TAMA is exempt from registration under the Advisers Act.[24]

Accordingly, the Court may wish to consider the issues presented to the District Court and Court of Appeals, and petitioners would welcome an opportunity to further brief and argue those issues as may be appropriate.[25]

21. *See, e.g., In re Permian Basin Area Rate Cases*, 390 U.S. 747, 823-824 (1968); *Griffin v. County School Board of Prince Edward County*, 375 U.S. 391, 392 (1964).

22. *See, Ohio Bureau of Employment Services v. Hodory*, 431 U.S. 471, 477 (1977); *See also, Boynton v. Virginia*, 364 U.S. 454, 457 (1960).

23. *See, Levin v. Mississippi River Fuel Corp.*, 386 U.S. 162 (1967) where Mr. Justice Clark said that the "point is so clear that we see no occasion for remanding the issue to the Court of Appeals for its consideration of the point, even though it be assumed that its opinion does not decide it. Effective judicial administration requires that we dispose of the matter here." *Id.* at 169-70.

24. Respondent concedes and agrees that Morgage Trust of America's investments are limited to "real estate mortgages of various types, other real estate loans and some equity interests in real estate . . ." (Res. Brief 3). Respondent further concedes and agrees that the "adviser" involved in this case, TAMA, has only one client —Mortgage Trust of America. (Res. Brief 3). The Advisers Act does not require registration of an investment adviser "who during the course of the preceding twelve months has had fewer than fifteen clients and who neither holds himself out generally to the public as an investment adviser nor acts as an investment adviser to any investment company . . ." 15 U.S.C. § 80b-3(b)(3) (1971).

25. *See generally*, Stern and Gressman, Supreme Court Practice § 6.27, 456-463 (5th ed. 1978).

CONCLUSION

For the reasons set forth in their opening brief and in the foregoing reply, petitioners respectfully pray for an order of this Court *reversing* the decision of the court below.

Respectfully submitted,

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